Supreme Court, U.S.
FILED
FEB 13 1992
OFFICE OF THE CLERK

No. 91-611

In The

Supreme Court of the United States

October Term, 1991

KEYTON E. BARKER and PAULINE BARKER, et al.,

Petitioners,

vs.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Writ of Certiorari to the Supreme Court of the State of Kansas

BRIEF FOR RESPONDENTS

MARK A. BURGHART
JAMES A. D. BARTLE *
MICHAEL M. REHM
Legal Services Bureau
Kansas Department of Revenue
Docking State Office Building
Topeka, Kansas 66612-1588
(913) 296-2381
* *Counsel of Record*

BEST AVAILABLE COPY

QUESTION PRESENTED

Whether a State violates 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity by taxing federal nondisability military retired pay while exempting from taxation retirement benefits paid by the State and its political subdivisions.

TABLE OF CONTENTS

Page

QUESTION PRESENTED i

TABLE OF AUTHORITIES vi

STATUTORY PROVISIONS INVOLVED 1

STATEMENT OF THE CASE 1

SUMMARY OF ARGUMENT 7

ARGUMENT 10

THE TAXATION OF FEDERAL NONDISABILITY MILITARY RETIRED PAY UNDER THE KANSAS INCOME TAX ACT DOES NOT VIOLATE 4 U.S.C. § 111 AND THE CONSTITUTIONAL DOCTRINE OF INTERGOVERNMENTAL TAX IMMUNITY 10

A. The differential tax treatment of military retirees and retired state and local governmental employees is directly related to and justified by significant differences between the two classes and is consistent with this Court's decision in *Davis v. Michigan Department of Treasury* 10

1. There are significant differences between military retireees and retired state and local government employees 10

a. Military retirees remain in the military service of the United States 11

TABLE OF CONTENTS—Continued

b. Military retired pay is current pay for current services 15

2. The differential tax treatment of military retired pay is "directly related to and justified by" significant differences between the two classes of taxpayers 19

a. The taxation of military retired pay is "directly related to" significant differences between the two classes of taxpayers 19

b. The taxation of military retired pay is "justified by" significant differences between the two classes of taxpayers 25

3. The taxation of military retired pay under the Kansas Income Tax Act is distinguishable from the taxation of federal civil service retirement benefits held invalid in *Davis v. Michigan Department of Treasury* 29

B. The taxation of military retired pay under the Kansas Income Tax Act is consistent with constitutional and statutory prinicples of intergovernmental tax immunity 33

1. The taxation of military retired pay under the Kansas Income Tax Act is not repugnant to the implied constitutional doctrine of federal tax immunity ... 34

a. The taxation of military retired pay under the Kansas Income Tax Act does not unduly interfere with the operations of the Federal Government 37

TABLE OF CONTENTS—Continued

b. As applied to the taxation of salaries paid to government employees, the constitutional doctrine of intergovernmental tax immunity should be narrowly construed 39

c. There are structural safeguards in Kansas state government which adequately protect the interests of military retirees 40

2. The taxation of military retired pay under the Kansas Income Tax Act does not violate 4 U.S.C. § 111 42

a. The statutory immunity for salaries of federal officers and employees is coextensive with that provided by the constitutional doctrine of intergovernmental tax immunity 42

b. The taxation of military retired pay under the Kansas Income Tax Act does not discriminate against the Federal Government or those with whom it deals 44

CONCLUSION 50

TABLE OF AUTHORITIES

CASES

Page

Alabama v. King & Boozer,
314 U.S. 1 (1941) 36

Ambrosini v. United States,
187 U.S. 1 (1902) 35

Berkey v. United States,
361 F.2d 983 (Ct. Cl. 1966) 16

Bohn v. Waddell,
164 Ariz. 74, 790 P.2d 772 (T.C. 1990),
aff'd on reconsideration, 82 Ariz. Adv. Rep. 52,807
P.2d 1 (T.C. 1991), *appeal pending*, No. 1 CA-TX
90-029 (Ariz. App. 1991) 26, 29

Buffington v. Day,
78 U.S. (11 Wall.) 113 (1871) 35, 37

Chambers v. Russell,
192 F. Supp. 425 (N.D. Cal. 1961) 12, 13

Clinton v. State Tax Commission,
146 Kan. 407, 71 P.2d 857 (1937) 44

Cornetta v. United States,
851 F.2d 1372 (Fed. Cir. 1988) 28

Costello v. United States,
587 F.2d 424 (9th Cir. 1978), *cert. denied*,
422 U.S. 929 (1979) 16

Davis v. Michigan Department of Treasury,
489 U.S. 803 (1989) ..... passim

Dobbins v. Commissioners of Erie County,
41 U.S. (16 Pet.) 435 (1842) 35, 37

Grant v. Grant,
9 Kan. App. 2d 671, 685 P.2d 327,
rev. denied 236 Kan. 875 (1984) 27

TABLE OF AUTHORITIES—Continued

Graves v. New York ex rel. O'Keefe,
306 U.S. 466 (1939) 8, 37, 38, 39
40, 42, 44, 49

Hackman v. Director of Revenue,
771 S.W.2d 77 (Mo. 1989), *cert. denied*,
493 U.S. 1019 (1990) 26, 29

Harper v. Virginia Department of Taxation,
___ S.E.2d ___(Va. 1991), *pet. for cert. pending*,
Case No. 91-794 29

Helvering v. Gerhardt,
304 U.S. 405 (1938) 37, 38, 39, 40, 44

Hooper v. Hartman,
163 F. Supp. 437 (S.D. Cal. 1958),
aff'd 274 F.2d 429 (9th Cir. 1959) 16

Hooper v. United States, 326 F.2d 982 (Ct. Cl. 1964)
cert. denied, 377 U.S. 977 (1964) 13

Hostinsky v. United States,
292 F.2d 508, 154 Ct. Cl. 443 (1961) 12

In re Siverling,
72 Bankr. 78 (W.D. Mo. 1987) 16

James v. Dravo Contracting Co.,
302 U.S. 134 (1937) 36

Kuhn v. Colorado,
817 P.2d 101 (Colo. 1991), *pet. for cert. pending*,
Case No. 91-950 29

Lemly v. United States,
75 F. Supp. 248 (Ct. Cl. 1948) 12

Mansell v. Mansell,
490 U.S. 581 (1989) 27, 28

Matter of Haynes,
679 F.2d 718 (7th Cir. 1982), *cert. denied*
sub nom. Miller v. Haynes, 459 U.S. 970 (1982) 15

McCarty v. McCarty, 453 U.S. 210 (1981) 8, 12, 16, 17,
18, 26, 27, 28, 31

TABLE OF AUTHORITIES—Continued

McCulloch v. Maryland,
17 U.S. (4 Wheat.) 316 (1819) 34, 35, 39, 40, 41, 44

Memphis Bank & Trust v. Garner,
459 U.S. 392 (1983) 42, 43

Metcalf v. Mitchell,
269 U.S. 514 (1926) 36

Michelin Tire Corp. v. Wages,
423 U.S. 276 (1976) 50

Montana v. United States,
440 U.S. 147, 170-171 (1979) (White, J., dissenting) 47

Phillips Chemical Co. v. Dumas Independent School Dist., 361 U.S. 376 (1960) 20, 23, 31, 32, 45, 46, 47

Pledger v. Bosnick,
306 Ark. 45, 811 S.W.2d 286 (1991),
pet. for cert. pending, Case No. 91-375 ..... 26, 29

Smith v. Davis,
323 U.S. 111 (1944) 43

South Carolina v. Baker,
485 U.S. 505 (1988) 35

Tradesmens Nat. Bank v. Oklahoma Tax Commission,
309 U.S. 560 (1940) 23, 46

Trinityfarm Constr. Co. v. Grosjean,
291 U.S. 466 (1934) 36

United States v. County of Fresno,
429 U.S. 452 (1977) 9, 48, 49

United States v. Department of Revenue of Illinois,
371 U.S. 21 (1962) 45

United States v. Detroit,
355 U.S. 466 (1958) 45, 47, 49

United States v. Tafoya,
803 F.2d 140 (5th Cir. 1986) 16, 28

TABLE OF AUTHORITIES—Continued

United States v. Tyler,
105 U.S. (15 Otto) 244 (1881) 8, 11, 12, 15, 16

Washington v. United States,
460 U.S. 536 (1983) 49, 50

Watson v. Watson,
424 F. Supp. 866 (E.D.N.C. 1976) 12

Weston v. City Council of Charleston,
27 U.S. (2 Pet.) 449 (1829) 34, 35

Willcuts v. Bunn,
282 U.S. 216 (1931) 35, 36

CONSTITUTION AND STATUTES

U.S. Constitution:
Art. I, Sec. 8 26

Art. I, Sec. 9, Cl. 8 14

Pub. L. 100-659, § 2(a), Nov. 15, 1988, 102 Stat. 3910 20

Pub. L. 101-650, Title III, § 306, 104 Stat 105 20

Public Salary Tax Act of 1939, ch. 54, § 4, 53 Stat. 575, 4 U.S.C. § 111 .....passim

Uniform Services Former Spouses Protection Act, Pub. L. No. 97-252, 96 Stat. 730 (1982) 27

5 U.S.C. § 5532 14

5 U.S.C. § 8312 14

5 U.S.C. § 8331(13) 23

10 U.S.C. § 101 23

10 U.S.C. § 101(43) 23

10 U.S.C. § 688(a) 12

10 U.S.C. § 772(c) 12

10 U.S.C. § 802(a)(4) 12

10 U.S.C. § 817(a) 14

TABLE OF AUTHORITIES—Continued

10 U.S.C. § 1074(b) 13
10 U.S.C. § 1076(b) 13
10 U.S.C. § 1086 13
10 U.S.C. § 1401 16
10 U.S.C. § 1401a 16
10 U.S.C. § 1405 23
10 U.S.C. § 1406 23
10 U.S.C. § 1407 23
10 U.S.C. § 1409 23
10 U.S.C. §§ 1461-1467 17
10 U.S.C. § 3075 12
10 U.S.C. § 3911 16
10 U.S.C. § 3914 16
10 U.S.C. § 3966 12
10 U.S.C. § 4621 14
10 U.S.C. § 6323 16
10 U.S.C. § 6330 16
10 U.S.C. § 6331 12
10 U.S.C. § 6483 13
10 U.S.C. § 7601 14
10 U.S.C. § 8075 13
10 U.S.C. § 8911 16
10 U.S.C. § 8914 16
10 U.S.C. § 8966 13
10 U.S.C. § 9621 14
26 U.S.C. § 61(a) 4
26 U.S.C. § 61(a)(11) 18
26 U.S.C. § 72(o) 6

TABLE OF AUTHORITIES—Continued

26 U.S.C. § 86 24
26 U.S.C. § 104 24
26 U.S.C. § 104(a) 2
28 U.S.C. § 178 20
28 U.S.C. § 377 20
31 U.S.C. § 742 ..... 42, 43
33 U.S.C. § 853o 23
33 U.S.C. § 857 23
33 U.S.C. § 857-2 23
33 U.S.C. § 857-3 23
33 U.S.C. § 857-4 23
33 U.S.C. § 864 23
37 U.S.C. § 801 14
38 U.S.C. § 310 27
38 U.S.C. § 331 27
38 U.S.C. § 1110 27
38 U.S.C. § 1131 27
38 U.S.C. § 5301 24
38 U.S.C. § 5301(a) 2
42 U.S.C. § 201 (p) 23
42 U.S.C. § 210(b) 23
42 U.S.C. § 212(c) 23
42 U.S.C. § 217 23
42 U.S.C. § 213a 23
1961 Kan. Sess. Laws, ch. 427, §§ 1, 3, 23; ch. 453, § 1 4
1973 Kan. Sess. Laws, ch. 398, § 1 5
1982 Kan. Sess. Laws, ch. 409, §§ 1, 2 5

TABLE OF AUTHORITIES—Continued

Kan. Stat. Ann. § 12-111a (1982) 4
Kan. Stat. Ann. § 12-5005 (Supp. 1990) 4
Kan. Stat. Ann. § 13-14a10 (1982) 4
Kan. Stat. Ann. § 14-10a10 (1982) 4
Kan. Stat. Ann. § 20-2618 (Supp. 1990) 4
Kan. Stat. Ann. § 23-201 et seq. (1988) 27
Kan. Stat. Ann. § 23-201(b) (1988) 27
Kan. Stat. Ann. § 60-223(b)(1) and (b)(2) (1983) 2
Kan. Stat. Ann. § 72-1768a (1985) 4
Kan. Stat. Ann. § 74-4914(1) (Supp. 1990) 17
Kan. Stat. Ann. § 74-4914(5) (Supp. 1990) 17
Kan. Stat. Ann. § 74-4914c (Supp. 1990) 18
Kan. Stat. Ann. § 74-4915(2) (Supp. 1990) 17
Kan. Stat. Ann. § 74-4919(1) (Supp. 1990) 6, 17
Kan. Stat. Ann. § 74-4919(2)(a) (Supp. 1990) 6
Kan. Stat. Ann. § 74-4921(1) (Supp. 1990) 17
Kan. Stat. Ann. § 74-4923(b) (Supp. 1990) 4
Kan. Stat. Ann. § 74-4957 (Supp. 1990) 18
Kan. Stat. Ann. § 74-4957a (Supp. 1990) 18
Kan. Stat. Ann. § 74-4978g (Supp. 1990) 4
Kan. Stat. Ann. § 79-3201 et seq. (1989) ..... passim
Kan. Stat. Ann. § 79-32,110 (1989) 4
Kan. Stat. Ann. § 79-32,111b(a) (1989) 6, 30
Kan. Stat. Ann. § 79-32,116 (1989) 3
Kan. Stat. Ann. 79-32,117 (Supp. 1990) ..... passim

TABLE OF AUTHORITIES—Continued

OTHER AUTHORITIES

26 C.F.R. § 1-61-11 (1980) 18

H.B. No. 1193 (1971) 5

H.B. No. 2704 (Amended) (1978) 5

H.R. Rep. No. 100-638, Part 1, 100th Cong., 2d Sess. (1988) 21

H.R. Rep. No. 101-374, 101st Cong. 2d Sess. (1990) ... 20

Handbook on Retirement Services for Army Personnel and Their Families, DA PAM 600-5 (1982) 14

Military Compensation Background Papers: Compensation Elements and Related Manpower Cost Items—Their Purposes and Legislative Backgrounds, (3rd ed. 1987) 13, 15, 16, 17, 18

Report on Kansas Legislative Interim Studies to the 1978 Legislature, Special Committee on Assessment and Taxation, Vol. II (1977) 5

Report on Kansas Legislative Interim Studies to the 1981 Legislature, Special Committee on Assessment and Taxation (1980) 5

Report on Kansas Legislative Interim Studies to the 1990 Legislature, Special Committee on Assessment and Taxation (1989) 5

S.B. No. 2 (1981) 5

S.B. No. 122 (1975) 5

S.B. No. 423 (1990) 5

S.B. No. 520 (1988) 5

S.B. No. 567 (1986) 5

Sen. Sub. for H.B. No. 2122 (1991) 5

S. Rep. No. 100-293, 100th Cong., 2d Sess. (1988) 21

S. Rep. No. 112, 76th Cong., 1st Sess. (1939) 43

Treas. Reg. § 1.61-2(a) (1991) 18

No. 91-611

In The

Supreme Court of the United States

October Term, 1991

KEYTON E. BARKER and PAULINE BARKER, et al.,

Petitioners,

vs.

STATE OF KANSAS; KANSAS DEPARTMENT OF REVENUE; SECRETARY OF REVENUE OF THE STATE OF KANSAS; and DIRECTOR OF TAXATION OF THE STATE OF KANSAS,

Respondents.

On Writ of Certiorari to the Supreme Court of the State of Kansas

BRIEF FOR RESPONDENTS

STATUTORY PROVISIONS INVOLVED

1. The relevant text of 4 U.S.C. § 111 is set forth in the Petition at 2-3.

2. The relevant text of Kan. Stat. Ann. § 79-32,117 (Supp. 1990) is set forth in the Appendix to the Petition at 47a-48a.

STATEMENT OF THE CASE

Parties and allegations

This action was commenced on April 17, 1989, by the filing of two separate petitions; one in the District Court

of Leavenworth County, Kansas (*Lober*, J.A. 9-13), and the other in the District Court of Shawnee County, Kansas (*Barker*, J.A. 3-9). These petitions were filed on the last day in which to claim a Kansas income tax refund for the 1984 tax year under the four-year statute of limitations then in effect. *Lober* was later transferred to the District Court of Shawnee County where it was consolidated with *Barker*. (J.A. 33-34).

Petitioners are retired members of the United States Armed Forces residing in Kansas.[1] After consolidation these proceedings were certified by the trial court as a class action pursuant to Kan. Stat. Ann. § 60-223(b)(1) and (b)(2) (1983). (J.A. 55). The class was designated as:

> All retired members of the federal or United States armed forces who are recipients of federal armed forces retirement benefits [under applicable provisions of Title 10 and Title 14 or (*sic*) the United States Code] subject to Kansas state income taxation during one or

---

[1] The class of taxpayers represented by petitioners consists exclusively of retired members of the United States Armed Forces. The petitioners' brief devotes considerable attention to the taxation of retirement benefits received by retirees of federal agencies such as the Public Health Service, the National Oceanic and Atmospheric Administration, the Central Intelligence Agency, the Foreign Service and the federal judiciary. (Pet. Br. 20-27). However, these retirees are not parties to this action and the taxation of their retirement benefits is not at issue.

As indicated in the affidavits filed by the representatives of the plaintiff class, all class members receive nondisability military retired pay which is taxable pursuant to the provisions of the Kansas Income Tax Act. (R. at 1053-1201). However, Kansas does not tax all military retirement benefits. Military disability retired pay and Veterans Administration pensions are exempt from Kansas income tax. 38 U.S.C. § 5301(a), 26 U.S.C. § 104(a), Kan. Stat. Ann. 79-32,117 (Supp. 1990). It is only the taxation of nondisability military retired pay that is at issue in this case.

> more of the tax years from 1984 through 1989 and, where applicable, their respective spouses who have filed or will file joint Kansas state income tax returns during one or more of the tax years from 1984 through 1989; (J.A. 56).

There are approximately 14,100 class members. (J.A. 53). Respondents are the State of Kansas, the Kansas Department of Revenue, the Secretary of Revenue of the State of Kansas and the Director of Taxation of the State of Kansas. The current Secretary of Revenue is Mark V. Beshears and the current Director of Taxation is Alisa M. Dotson. Neither Beshears nor Dotson held office at the time this action was commenced.

The Kansas Income Tax Act, Kan. Stat. Ann. § 79-3201 *et seq.* (1989) ("KITA"), provides that military retired pay is taxable while retirement benefits paid by the State and its political subdivisions are exempt from taxation. Petitioners allege this practice is discriminatory and violates 4 U.S.C. § 111 and constitutional principles of intergovernmental tax immunity as discussed and applied in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989). (J.A. 42-43). Petitions sought a declaratory judgment invalidating the relevant provisions of the KITA, a permanent injunction prohibiting respondents from further enforcement thereof, and refunds of all Kansas income tax paid on petitioners' military retired pay since the 1984 tax year. (J.A. 47).

The Kansas income tax scheme

Kan. Stat. Ann. § 79-32,117 (Supp. 1990) provides that an individual's Kansas adjusted gross income shall be his or her federal adjusted gross income with certain modifications. Kansas adjusted gross income, less deductions and personal exemptions, constitutes Kansas taxable income. Kan. Stat. Ann. § 79-32,116 (1989). The appropriate income tax rate is applied to Kansas taxable income to determine

an individual's Kansas income tax liability. Kan. Stat. Ann. § 79-32,110 (1989).

Both military retired pay and retirement benefits paid by the State of Kansas and its political subdivisions are included in federal adjusted gross income and subject to federal income tax. 26 U.S.C. § 61(a) (1988). Retirement benefits paid by the State and its political subdivisions are specifically exempt from Kansas income tax[2] and federal adjusted gross income is modified to exclude such amounts in determining Kansas adjusted gross income. Kan. Stat. Ann. § 79-32,117(c)(ii) (Supp. 1990). There is no corresponding modification to exclude military retired pay. The result is that state and local government retirement benefits are exempt from Kansas income tax while military retired pay is taxable.[3]

---

[2] Kan. Stat. Ann. § 12-111a (1982), § 12-5005 (Supp. 1990), § 13-14a10 and § 14-10a10 (1982) [exempting benefits paid to retired policemen and firemen under local retirement plans]; Kan. Stat. Ann. § 20-2618 (Supp. 1990) [exempting benefits paid under the retirement system for state judges]; Kan. Stat. Ann. § 72-1768a (1985) [exempting benefits paid under the school employee's retirement system]; Kan. Stat. Ann. § 74-4923(b) (Supp. 1990) [exempting retirement benefits paid under the Kansas Public Employees Retirement System ("KPERS") and Kansas Police and Fireman's Retirement System ("KP&F")]; Kan. Stat. Ann. § 74-4978g (Supp. 1990) [exempting highway patrol pension fund benefits payable under KP&F]; Kan. Stat. Ann. § 79-32,117(c)(ix) (Supp. 1990) [exempting benefits paid to retired city employees]; Kan. Stat. Ann. 79-32,117(c)(xiii) (Supp. 1990) [exempting benefits paid to retired employees of boards of public utilities].

[3] The State of Kansas first enacted an income tax in 1933. In 1961, the Kansas Legislature created the Kansas Public Employees Retirement System ("KPERS") and enacted an income tax exemption for both KPERS benefits and federal civil service retirement benefits. 1961 Kan. Sess. Laws, ch. 427, §§ 1, 3, 23; ch. 453, § 1. Amounts received as supplemental annuities by federal railroad retirees were later specifically exempted from Kansas

There are, however, two qualifications to this general

---

income tax. 1973 Kan. Sess. Laws, ch. 398, § 1.

In 1971, the Legislature rejected a proposal to exempt military retired pay from Kansas income tax. H.B. No. 1193 (1971). Two years later a provision was enacted permitting military retirees over age 65 to exclude from Kansas adjusted gross income up to $2,000 received as retirement benefits for services in the armed forces. 1973 Kan. Sess. Laws, ch. 398, § 1. Proposals to increase the allowable exclusion for military retirement benefits were rejected in 1975, 1978 and 1981. S.B. No. 122 (1975); H.B. No. 2704 (Amended) (1978); S.B. No. 2 (1981). In 1982, the $2,000 exclusion was repealed and replaced by a $120 income tax credit for military retirees age 62 or older. 1982 Kan. Sess. Laws, ch. 409, §§ 1, 2. Proposals to abandon the $120 credit in lieu of a substantially increased exemption for amounts received as military retired pay were rejected in 1986 and 1988. S.B. No. 567 (1986); S.B. No. 520 (1988). In 1990, a proposal to abandon the $120 income tax credit in lieu of a total exemption for all amounts received as military retired pay was rejected. S.B. No. 423 (1990). In 1991, the Legislature approved a bill which would have exempted all amounts received as military retired pay. Sen. Sub. for H.B. No. 2122 (1991). The measure was vetoed by the Governor and an attempted override was unsuccessful.

On three occasions since 1977 the Legislature has empaneled a Special Committee on Assessment and Taxation to make findings and recommendations regarding the taxation of pensions and retirement benefits, including military retired pay. Reports compiled by these committees were considered in connection with the many proposals relating to the income tax treatment of military retirees. Report on Kansas Legislative Interim Studies to the 1978 Legislature, Special Committee on Assessment and Taxation, Vol. II, pp. 376-385 (1977); Report on Kansas Legislative Interim Studies to the 1981 Legislature, Special Committee on Assessment and Taxation, pp. 54-66 (1980); Report on Kansas Legislative Interim Studies to the 1990 Legislature, Special Committee on Assessment and Taxation, pp. 131-134 (1989). Unquestionably, the taxation of military retired pay has been one of the most prominent and persistent issues faced by the Kansas Legislature in the last 20 years.

rule. First, the Kansas Public Employees Retirement System ("KPERS") is a contributory retirement system in which participating employees make mandatory contributions to their retirement fund each payroll period. Kan. Stat. Ann. § 74-4919(1) (Supp. 1990). Although these contributions are "picked up" by the employer [Kan. Stat. Ann. § 74-4919(2)(a) (Supp. 1990)], and not subject to federal income tax [26 U.S.C. § 72(o) (1988)], they are required to be added to federal adjusted gross income for purposes of determining Kansas adjusted gross income and are thereby subject to Kansas income tax in the year in which they are made. Kan. Stat. Ann. § 79-32,117(b)(vi) (Supp. 1990). Thus, when KPERS benefits are paid out upon retirement, that portion of the benefits attributable to employee contributions has already been subject to Kansas income tax. Second, military retirees age 62 or older who receive military retirement benefits are entitled to claim a $120 credit against their Kansas income tax liability. Kan. Stat. Ann. § 79-32,111b(a) (1989). Therefore, certain members of the class represented by petitioners pay tax on only a portion of their military retired pay.

Disposition in the courts below

Petitioners moved for summary judgment arguing that the taxation of military retired pay under the KITA was invalid as a matter of law. (J.A. 57). The trial court rejected petitioners' claims finding that there were substantial differences between military retirees and retired state and local government employees which justified different tax treatment and that the KITA did not violate 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity. (J.A. 68). Petitioners' motion was denied and judgment entered for respondents. (J.A. 69-70). Petitioners appealed to the Court of Appeals of the State of Kansas (J.A. 70), and their motion to transfer the appeal to the

Supreme Court of the State of Kansas was subsequently granted.

In a unanimous decision published at 249 Kan. 186, 815 P.2d 46 (1991), the Kansas Supreme Court affirmed the trial court's decision. The court held that the taxation of federal military retirement benefits under the KITA meets the requirements of *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), and that the KITA does not discriminate against federal military retirees in a manner that violates 4 U.S.C. § 111 (1988) and constitutional principles of intergovernmental tax immunity. (Pet. App. 1a).

SUMMARY OF ARGUMENT

This case can be decided on narrow grounds by application of the recent precedent in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), or on broad policy grounds by reference to the constitutional doctrine of intergovernmental tax immunity and its statutory counterpart, 4 U.S.C. § 111. Either approach yields the same result: the taxation of nondisability military retired pay under the Kansas Income Tax Act [Kan. Stat. Ann. § 79-3201 *et seq.* (1989) ("KITA")], is valid because it does not discriminate against federal military retirees in violation of the Constitution and laws of the United States.

1. It is undisputed that the State of Kansas has the authority to tax the compensation paid by the Federal Government to military retirees residing in Kansas. The only prohibition is that the tax may not discriminate "because of the source of the pay or compensation." 4 U.S.C. § 111. The KITA provides that military retired pay is taxable while retirement benefits paid by the State of Kansas and its political subdivisions are exempt from Kansas income tax. However, this differential tax treatment is permissible because it is "directly related to and justified by 'significant

differences between the two classes' " of taxpayers. *Davis*, 489 U.S. at 816.

The manner in which Congress has chosen to regulate the United States Armed Forces causes military retirees to be uniquely situated in relation to all other retirees and gives rise to the significant differences between the two classes. Military retirees remain members of the armed forces and retain their military status. *United States v. Tyler*, 105 U.S. (15 Otto) 244 (1881). Unlike state and local government retirees, who do not continue employment in a reduced or contingent capacity and are not required to perform any additional duties, military retirees continue to be employed by the Federal Government and have continuing obligations in connection with their employment. Further, while state and local government pension benefits are deferred compensation for prior services, military retired pay is "reduced compensation for reduced current services" which "differs in some significant respects from a typical pension or retirement plan." *McCarty v. McCarty*, 453 U.S. 210, 221-222 (1981).

For these reasons, the differential tax treatment at issue is based on actual and substantial differences between the two classes of taxpayers and not on the federal source of military retired pay. The fact that certain federal retirement benefits other than military retired pay are exempt from Kansas income tax is further evidence that the KITA is not designed to discriminate against federal retirees.

2. The purpose of the implied constitutional doctrine of intergovernmental tax immunity is to prevent undue interference with the operations of one government by imposing on it the tax burdens of the other. *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 483-484 (1939). The taxation of military retired pay does not impose either a legal or economic burden on the Federal Government. Further,

neither the petitioners nor the United States, as *amicus curiae* in support of petitioners, have alleged that the tax on military retired pay actually interferes with the operations of the Federal Government.

Consistent with constitutional and statutory principles of federal tax immunity, a State may impose a nondiscriminatory income tax on compensation paid to federal retirees. The exemption for state and local government retirement benefits does not cause the taxation of military retired pay to be discriminatory. In light of the manifold differences between these two classes of taxpayers, they are not "similarly situated consitutents" of the State of Kansas and federal law does not require that they be taxed in the same manner. *United States v. County of Fresno*, 429 U.S. 452 (1977). Military retirees are adequately protected against discriminatory state taxation because they themselves participate and are represented in the state political process and they receive the same tax treatment as private sector retirees.

Under both the Constitution and 4 U.S.C. § 111, the scope of federal tax immunity is very narrow when asserted by federal officers and employees to defeat a state income tax imposed on their pay or compensation. To construe the immunity as requiring equal tax treatment of two classes of taxpayers as dramatically different as these here would be an unreasonably broad construction, and would result in a corresponding curtailment of a State's right to exercise its sovereign power of taxation and order its own affairs.

ARGUMENT

THE TAXATION OF FEDERAL NONDISABILITY MILITARY RETIRED PAY UNDER THE KANSAS INCOME TAX ACT DOES NOT VIOLATE 4 U.S.C. § 111 AND THE CONSTITUTIONAL DOCTRINE OF INTERGOVERNMENTAL TAX IMMUNITY.

A. The differential tax treatment of military retirees and retired state and local government employees is directly related to and justified by significant differences between the two classes and is consistent with this Court's decision in *Davis v. Michigan Department of Treasury.*

This action was filed as a direct response to the decision in *Davis v. Michigan Department of Treasury,* 489 U.S. 803 (1989), where a state income tax scheme favoring retired state and local government employees over retired federal civil service employees was declared invalid. 489 U.S. at 817. This Court found that the differential tax treatment was not directly related to and justified by significant differences between the two classes of taxpayers and therefore violated 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity. 489 U.S. at 816-817.

This case involves military retirees, not federal civil service retirees, and raises issues not presented in *Davis.* There are significant differences between military retirees and retired state and local government employees and the differential tax treatment at issue is directly related to and justified by those differences. In essence, Kansas succeeds where Michigan failed.

1. There are significant differences between military retirees and retired state and local government employees.

The mission of the United States Armed Forces—to wage war and maintain national security—is unlike that of civilian government and private industry. The armed forces must be prepared to commence military operations at a moment's notice and the availability of skilled personnel must be assured. Disciplinary measures are required to maintain an adequate level of preparedness and insure efficiency in the chain of command. Congress has addressed these vital concerns by implementing personnel management methods for members of the armed forces that have no parallel elsewhere in the public or private sector. The unique purpose and function of military retirees causes both their status and the character of their compensation to differ substantially from that of all other retirees.

a. Military retirees remain in the military service of the United States.

In *United States v. Tyler*, 105 U.S. (15 Otto) 244 (1881), this Court stated that a retired United States Army officer remains in the military service and is "by law a part of the army." 105 U.S at 246. Retirement from active service is "manifest[ly] differen[t]" than "retiring wholly and altogether from the service." *Id.* at 245. While not required to perform full service, a retired officer is part of the army and may be assigned to duty. The names of retired officers are maintained on the Army Register, they are entitled to wear their military uniforms and they are subject to the rules and articles of war and trial by court-martial. *Id.* at 246. The Court stated "it is impossible to hold that * * * (retired officers) * * * are still *not* in the military service." *Id.* (Emphasis in original). Their retirement pay is "compensation continued at a reduced rate, and the connection (with the military service) is continued with a retirement from active service only." *Id.* at 245.

The Court's findings in *Tyler* over a century ago continue to be true today under current provisions of federal law[4] and subsequent decisions of all federal courts that have addressed the status of military retirees.[5]

Military retirees do not remain in the armed forces as a mere formality[6] nor is the involuntary recall of military

---

[4] The Regular Army includes retired officers and enlisted personnel, 10 U.S.C. § 3075(b)(3); the Secretary of the Army shall maintain a list of all retired officers, warrant officers and enlisted personnel, 10 U.S.C. § 3966; retired officers may wear their military uniforms, 10 U.S.C. § 772(c); all retired members of the Regular Army are subject to involuntary recall to active duty, 10 U.S.C. § 688(a); retired members of the armed forces entitled to receive pay are subject to the Uniform Code of Military Justice and court-martial jurisdiction, 10 U.S.C. § 802(a)(4). Each branch of the armed forces has substantially the same nondisability retirement system. *McCarty v. McCarty*, 453 U.S. 210, 213 (1981).

[5] *See e.g., Watson v. Watson*, 424 F. Supp. 866, 868 (E.D.N.C. 1976) ("In effect, the defendant continues to hold the same office, that is, a retired colonel, that he held while he was on active duty, and he continues to receive compensation for this employment."); *Chambers v. Russell*, 192 F. Supp. 425, 427 (N.D. Cal. 1961) ("[A] retired officer entitled to receive pay is not so divorced from the military to be considered a mere civilian, but is part of the military and has military status."); *Lemly v. United States*, 75 F. Supp. 248, 249 (Ct. Cl. 1948) ("Even though an officer is retired from active duty and is receiving retirement pay * * * he is still an officer in service of his country even though on the retired list."); *Hostinsky v. United States*, 292 F.2d 508, 510, 154 Ct. Cl. 443 (1961) ("We think than an officer in the Navy, though retired, is still an officer.").

[6] Numerous sections of Title 10 of the United States Code refer to retired lists or state that military retirees are part of the service branch from which they retire. 10 U.S.C. § 3075 (Regular Army includes retired officers and enlisted members); 10 U.S.C. § 3966 (Secretary of the Army shall maintain a list of all retired officers, warrant officers and enlisted members); 10 U.S.C. § 6331 (transfer from Fleet Reserve or Fleet Marine Corps Reserve to retired list

retirees an abstract theory.[7] One of the primary purposes of the military retirement system is to maintain "a pool of experienced military manpower that can be called upon in time of war or national emergency to augment the active-duty forces of the United States." *Military Compensation Background Papers: Compensation Elements and Related Manpower Cost Items—Their Purposes and Legislative Backgrounds,* (3rd ed. 1987) at 367 ("*Military Compensation Background Papers*"). The involuntary recall of military retirees in connection with United States military operations in the Persian Gulf illustrates their vital role in our system of national defense.

Consistent with their continuing status as officers and employees of the United States, military retirees are entitled to various privileges and employee benefits not available to other retirees and members of the general public. These include free or subsidized medical and dental care [10 U.S.C. §§ 1074(b), 1076(b), 1086], free travel on military

---

of Regular Navy or Regular Marine Corps); 10 U.S.C. § 6483 (pertaining to retired naval officers recalled to active duty); 10 U.S.C. § 8075 (Regular Air Force includes all retired officers and enlisted members); 10 U.S.C. § 8966 (Secretary of the Air Force shall maintain retired list of all retired officers, warrant officers and enlisted members).

[7] *Cf. Chambers v. Russell,* 192 F.Supp. 425, 428 (N.D. Cal. 1961) ["an officer of the United States in retired military status may reasonably be expected to * * * hold himself ready and fit for recall to active duty, in so far as he is subject to an involuntary return to service in the event of war or national emergency."]; *Hooper v. United States,* 326 F.2d 982, 987 (Ct. Cl. 1964), *cert. denied,* 377 U.S. 977 (1964) ["The salary (a retired Navy Officer) received was not solely recompense for past services, but a means devised by Congress to assure his availability and preparedness in future contingencies. He has a direct connection with the operation of the 'land and naval forces.' Thus, he formed a part of a vital segment of our national defense."].

aircraft [*Handbook on Retirement Services for Army Personnel and Their Families*, DA PAM 600-5, at 6 (1982)] and authorization to shop at military commissaries [10 U.S.C. § 4621 (Army), § 7601 (Navy and Marines), § 9621 (Air Force)].

Military retirees are also subject to substantial restrictions on their post-retirement activities. Because they remain members of the armed forces, the Federal Government has a legitimate interest in regulating their conduct and activities. Retired officers are prohibited from employment with any foreign government [U.S. Const. Art. I, Sec. 9, Cl. 8], and from working for defense contractors within three years after retirement [37 U.S.C. § 801]. Their retirement pay may be reduced if they take other employment with the Federal Government. 5 U.S.C. § 5532. The court-martial jurisdiction of the Uniform Code of Military Justice extends to offenses committed by military retirees subsequent to retirement [10 U.S.C. § 817(a)], and military retired pay may be forfeited upon conviction for certain crimes [5 U.S.C. § 8312].

In stark contrast, retired state and local government employees have no continuing connection with their former employer. They are completely severed from employment, they are not subject to involuntary recall to active duty, they are not subject to any personnel procedures or disciplinary rules and regulations and they are not entitled to any benefits otherwise available to current employees. (J.A. 58-59).

Military retirees remain in the military service of the United States. They do not become civilians when they retire from active duty nor are they discharged from the armed forces. Upon retirement their employment status changes but it does not terminate. They are required to perform certain duties and failure to perform those duties

may result in termination of their retired pay. *Matter of Haynes*, 679 F.2d 718, 719 (7th Cir. 1982), *cert. denied sub nom. Miller v. Haynes*, 459 U.S. 970 (1982). Retired state and local government employees do not continue employment in a reduced or contingent capacity nor are they required to perform any additional duties in order to receive their retirement benefits. (J.A. 61).

In a 1987 report, the United States Department of Defense stated:

> It should be noted that, while there may be a superficial resemblance between the military retirement system and retirement systems that exist in the private sector, *there are in fact substantial differences between the military retirement system and all other retirement systems*—including that of Federal civil servants. *Military Compensation Background Papers*, at 367 (emphasis added).

Plainly, "the military retirement system is unique to all other retirement systems." (J.A. 68). It is different from KPERS and all other state and local government retirement systems. The "substantial differences" noted by the Department of Defense compel the conclusion that there are "significant differences" between the two classes of taxpayers.

b. Military retired pay is current pay for current services.

Since the military retirement system is substantially different than all other retirement systems, it is unsurprising that there are significant differences between military retired pay and state and local government retirement benefits.[8] As stated in *Tyler*, military retired pay is "compen-

---

[8] For persons joining the armed forces prior to September 8, 1980, (which includes all members of the class represented by petitioners) retired pay is calculated pursuant to a statutory for-

sation * * * continued at a reduced rate, and the connection is continued, with a retirement from active service only." 105 U.S. at 245. In *McCarty v. McCarty*, 453 U.S. 210, 222 (1981), this Court stated that "military retired pay is reduced compensation for federal current services."[9]

In *Davis* it was determined that federal civil service retirement benefits are "deferred compensation for past years of service rendered to the Government." 489 U.S. at 808 (citations omitted). However, military retired pay is not deferred compensation or a pension. It "differs in some significant respects from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221.[10]

---

mula and may not exceed 75 percent of the basic pay of the retired grades of the service member. 10 U.S.C. § 1401; *Military Compensation Background Papers*, at 373. A minimum of 20 years of service is required to be eligible to retire and receive military retired pay. Retirees may immediately begin to draw full retirement pay without a minimum age requirement. 10 U.S.C. §§ 3911, 3914 (Army), §§ 6323, 6330 (Navy and Marines), §§ 8911, 8914 (Air Force) *Military Compensation Background Papers*, at 381, 385. Retired pay is adjusted annually based on the Consumer Price Index. 10 U.S.C. § 1401a.

[9] *Cf. Costello v. United States*, 587 F.2d 424, 427 (9th Cir. 1978), *cert. denied*, 442 U.S. 929 (1979) ("[R]etired pay does not differ from active duty pay in its character as pay for continuing military service."); *United States v. Tafoya*, 803 F.2d 140, 142 (5th Cir. 1986) (Unlike most forms of federal retirement pay, military retired pay is "current pay" designed in part to compensate military retirees for their continued readiness to return to duty.).

[10] *See, e.g., In re Siverling*, 72 Bankr. 78, 79 (W.D. Mo. 1987) ("Military retirement is more like wages than a pension."); *Berkey v. United States*, 361 F.2d 983, 987 n.9 (Ct. Cl. 1966) (military retired pay is not a pension, grant or gratuity.); *Hooper v. Hartman*, 163 F.Supp. 437, 441 (S.D. Cal. 1958), *aff'd* 274 F.2d 429 (9th Cir. 1959) (pay received by a retired Navy officer "is not a pension or annuity, but is an emolument of and dependent upon the office so held.").

It is undisputed that retirement benefits paid by the State of Kansas and its political subdivisions are deferred compensation for prior service rather than current compensation for current service. State and local government retirement benefits are funded by regular employee and employer contributions made during the period of employment and investment earnings thereon. Kan. Stat. Ann. §§ 74-4919(1) (Supp. 1990), 74-4921(1) (Supp. 1990). (J.A. 60). In contrast, the military retirement system is noncontributory. No periodic contributions are made to any retirement fund by either the service member or the Federal Government during the period of active service. Instead, military retired pay is fully funded by annual appropriations from Congress. *McCarty*, 453 U.S. at 214; 10 U.S.C. §§ 1461-1467; *Military Compensation Background Papers*, at 381.

Employee contributions to KPERS are subject to Kansas income tax in the year in which they are made and KPERS benefits include these previously taxed contributions. Kan. Stat. Ann. § 79-32,117(b)(vi) (Supp. 1990). In contrast, no portion of military retired pay is taxed by the State of Kansas before such benefits are paid out to military retirees. (Pet. App. 26a).

Depending upon their age at induction, it is possible for members of the armed forces to retire and draw full benefits prior to age 40. In contrast, the normal retirement age for KPERS members is age 65. Kan. Stat. Ann. § 74-4914(1) (Supp. 1990). KPERS members may retire as early as age 55 but they do not receive full benefits nor do their benefits increase when they attain age 65. Kan. Stat. Ann. §§ 74-4914(5) (Supp. 1990), 74-4914(2) (Supp. 1990).[11] Con-

[11] Certain correctional employees may retire with full benefits at age 55 or take early retirement with reduced benefits at age

versely, entitlement to military retired pay is an "all or nothing proposition. * * * The military retirement system, in marked contrast to private-sector and Civil Service retirement systems, does not provide for the gradual vesting of retirement benefits." *Military Compensation Background Papers*, at 368.

In summary, this Court has stated that "military retired pay *differs in some significant respects* from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221 (emphasis added).[12] Petitioners themselves concede that "military retirement benefits are unique in comparison to other federal retirement benefits." (Pet. App. 29a). In ruling on the merits, the court below placed principal reliance on the fact that military retired pay is current compensation for current services and reasoned that a State is justified in taxing current compensation while not taxing deferred compensation. (Pet. App. 30a). Clearly, there are significant differences between the two classes of taxpayers based on the character of their compensation.

---

50. Kan. Stat. Ann. § 74-4914c (Supp. 1990). Police and firemen may retire with full benefits at age 55 with 20 years of service or take early retirements with reduced benefits at 50 with 20 years of service. Kan. Stat. Ann. §§ 74-4957, 74-4957a (Supp. 1990).

[12] Petitioners urge the Court to disregard *McCarty* because it is a "nontax case." (Pet. Br. at 8, 20). However, they cite repeatedly to *McCarty* to support their claim that military retired pay is a "pension" for federal income tax purposes. (Pet. Br. at 8-9; 27-29). However, *McCarty* states only that military retired pay "is taxable as ordinary income when received." 453 U.S. at 214 n.7. The authorities cited do not state that military retired pay is a pension. 26 U.S.C. § 61(a)(11); 26 C.F.R. § 1-61-11 (1980). In fact, Treas. Reg. § 1.61-2(a) (1991) provides that "pay of persons in the military or naval forces of the United States, *retired pay of employees*, pensions and retirement allowances" are taxable as compensation for services in the same manner as wages and salaries. (Emphasis added).

2. The differential tax treatment of military retired pay is "directly related to and justified by" significant differences between the two classes of taxpayers.

As demonstrated above, there are significant differences between military retirees and retired state and local government employees in the terms and conditions of their retirement and in the character of their compensation. As required by *Davis*, the differential tax treatment of military retired pay is "directly related to and justified by" these significant differences and is therefore valid. 489 U.S. at 816.

a. The taxation of military retired pay is "directly related to" significant differences between the two classes of taxpayers.

In *Davis* the State of Michigan argued that a tax imposed on federal civil service retirement benefits but not on state and local government retirement benefits was valid because most federal retirees receive a larger pension than their state counterparts. 489 U.S. at 816-817. However, this alleged difference did not hold true in all instances; certain exempt state and local government pensions were larger than certain taxable federal pensions. *Id.* at 817. Hence, the differential tax treatment was not "directly related to" the purported justification. Here, however, the differences between those receiving military retired pay and state and local government retirement benefits "are common to all members of each class." (Pet. App. 28a).

All military retirees remain members of the armed forces and are regulated as such whereas all state and local government retirees are completely severed from employment and have no continuing connection with their former employer. All military retirees receive current pay for current services whereas all state and local government retirees receive deferred compensation for prior services. Thus, "an

evenhanded application of the rationale" for taxing military retirees does not result in the taxation of any state and local government retirees. *Davis*, 489 U.S. at 817, citing *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 384-385 (1960). For this reason, the differential tax treatment of military retired pay is "directly related to" the differences between the two classes of taxpayers and satisfies the first prong of the *Davis* test.

Petitioners' arguments to the contrary are crafted in a clever, yet ultimately unpersuasive, manner. Their central premise is as follows: the reasons proffered to support differential taxation of military retirees do not also support the taxation of other federal retirees, thus the taxation of military retirees is not directly related to the purported differences but is based on the federal source of military pay. (Pet. Br. 19-27). This theory explains the subtle shift in petitioners' argument from an initial focus on the differences between military retirees and retired state and local government employees to a comparison of "favored and disfavored government retirees." (Pet. Br. 19). It is only in this manner that petitioners are able to argue that the status and characteristics of other federal retirees, whose interests are not at issue here, have any bearing on the question presented.[13]

---

[13] Petitioners would have been hardpressed to include some of the other federal retirees in their petition filed in April, 1989. The retirement system for Court of Claims judges under 28 U.S.C. § 178 was created in December, 1990, by the enactment of Pub. L. 101-650, Title III, § 306, 104 Stat. 105, over a year and a half after the petition was filed. Prior to the 1990 legislation, Claims Court judges were under the federal civil service retirement system. H.R. Rep. No. 101-374, 101st Cong. 2d Sess., at 26 (1990). The retirement system for federal magistrates and bankruptcy judges under 28 U.S.C. § 377 was added by Pub. L. 100-659, § 2(a), Nov. 15, 1988, 102 Stat. 3910. Prior to this new re-

This approach fails because it does not address the allegations upon which this action is based. Petitioners' claims rest squarely on the lack of any significant differences between military retirees and retired state and local government employees. (J.A. 11-12; 42-43). There is a conspicious absence in the pleadings of any reference to the taxation of other federal retirement benefits or any intimation that the tax treatment of other federal retirees is relevant to the validity of the taxation of military retirees.

The realities encountered in the course of this litigation explain the transformation in petitioners' theory of the case. The *Davis* decision was handed down on March 28, 1989. Without making adequate inquiry, petitioners automatically assumed that the taxation of military retired pay was invalid for the same reasons the taxation of federal civil service retirement benefits was held invalid in *Davis*. Petitioners had two powerful incentives to file suit at the earliest possible opportunity. First, to claim income tax refunds for the 1984 tax year prior to the expiration of the statute of limitations on April 17, 1989. Second, to win the "race to the courthouse" and be first in line to seek certification of this matter as a class action. In their haste, petitioners overlooked the unique status of military retirees in relation to all other retirees that has long been recognized by a host of authorities, including this Court and the Federal Government. Respondents subsequently brought these dif-

---

tirement system created in November, 1988, magistrates and bankruptcy judges were under the federal civil service retirement system. S. Rep. No. 100-293, 100th Cong., 2d Sess., at 3 (1988); H.R. Rep. No. 100-638, Part 1, 100th Cong., 2d Sess., at 9 (1988). Respondents have determined that only one federal magistrate from the District of Kansas has retired. He retired in 1985 under the federal civil service system and his retirement benefits are therefore exempt from Kansas income tax. Kan. Stat. Ann. 79-32,117(c)(vii) (Supp. 1990).

ferences to light and were granted summary judgment on the merits. Petitioners then had no option but to abandon their original position and attempt to analogize the plight of military retirees to that of other federal retirees whose retirement benefits are also subject to Kansas income tax. This approach might merit consideration if the class they represent included these other federal retirees, but it does not. Consequently, petitioners have been reduced to arguing issues other than those raised in the pleadings on behalf of taxpayers whom they do not represent.

The Kansas Supreme Court correctly concluded that the taxation of other federal retirees was immaterial to the validity of the taxation of military retirees. (Pet. App. 29a). This conclusion rested in part on petitioners' concession that "military retirement benefits are unique in comparison to other federal retirement benefits." *Id.* Petitioners' acknowledgment of the special status of military retirees detracts from their analysis of the differences between "favored and disfavored government retirees." Because military retirees are unique and thus unlike other "disfavored government retirees," they should not be grouped together to determine if they as a class are significantly different than those that are "favored." The court below reserved for another day questions regarding the taxation of other federal retirees. (J.A. 29a). This Court should likewise decline to address issues that are beyond the scope of the pleadings and not fairly embraced in the question presented.

Respondents agree that the justifications supporting taxation of military retirees do not necessarily support the taxation of other federal retirees.[14] Due to their unique

---

[14] The classification of retirees of the Public Health Service (PHS) and the National Oceanic and Atmospheric Administration (NOAA) with military retirees may be appropriate. Section

status, the differences between military retirees and retired state and local government employees are more extensive and profound than those between retired state and local government employees and any other class of federal retirees. Given the singular status of military retirees, the taxation of other federal retirees does not affect whether the taxation of military retired pay is valid. Due to their special standing in relation to the Federal Government and the manner in which they are treated by Congress, military retirees are uniquely situated and petitioners' attempts to group them with other federal retirees are unavailing.

The Court should examine "the whole tax structure of the state" in considering the validity of the Kansas income tax treatment of military retirees. *Phillips Chemical Co.*, 361 U.S. at 383, citing *Tradesmens Nat. Bank v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940). But, in the final analysis, such an examination reveals only that Kansas taxes

---

101(43) of Title 10 of the United States Code defines uniformed service as the Army, Navy, Air Force, Marine Corps, Coast Guard, PHS, or NOAA. *Accord* 5 U.S.C. § 8331(13); 42 U.S.C. § 201(p). Other statutes pertaining to the PHS include: 42 U.S.C. § 212(c) (retired officers subject to involuntary recall); 42 U.S.C. 213a (commissioned officers entitled to rights, benefits, privileges and immunities provided for Army commissioned officers); 42 U.S.C. § 210(b) (retired officers entitled to commissary and post exchange privileges); 42 U.S.C. § 217 (in time of war or emergency President can subject commissioned corps to Uniform Code of Military Justice); 42 U.S.C. § 213(a) (eligibility for military benefits). Other statutes pertaining to NOAA include: 33 U.S.C. § 864 (all laws relating to retirement of commissioned Navy officers apply to commissioned officers of NOAA); 33 U.S.C § 857-2 (retired list and recall from retirement); 33 U.S.C. § 853o (references retirement pay to member of Armed Forces under 10 U.S.C. §§ 101, 1405, 1406, 1407, 1409); 33 U.S.C. §§ 857, 857-3 (eligibility for servicemen's and veteran's benefits); 33 U.S.C. § 857-4 (commissary privileges).

certain federal retirement benefits and does not tax others.[15] For example, unlike the Michigan statutory scheme at issue in *Davis*, federal civil service retirement benefits are exempt from taxation under the KITA. Kan. Stat. Ann. § 79-32,117(c)(vii) (Supp. 1990). Since the Federal Government is the source of both federal civil service retirement benefits and military retired pay, the fact that the former is exempt while the latter is taxable belies petitioners' claim that the taxation of military retired pay is based on its source. Since other benefits from the same source are exempt, the basis for taxation of military retired pay must rest elsewhere.

Further examination of the manner in which all retirement benefits are taxed under the KITA reveals no broad purpose or intent to discriminate against federal retirees generally. Federal civil service retirees are favored above all other retirees, including state and local government employees. Not only are federal civil service retirement benefits exempt from taxation, there is no tax on employee contributions to the Federal Civil Service Disability and Retirement Fund. In contrast, employee contributions to KPERS are taxable in the year in which they are made. Kan. Stat. Ann. § 79-32,117(b)(vi) (Supp. 1990). Also, military retirees age 62 or older receive a $120 income tax credit that is not available to any other class of retirees. Taken as a whole, it is difficult to conclude that the KITA

---

[15] Kansas does not tax federal civil service retirement benefits [Kan. Stat. Ann. § 79-32,117(c)(vii) (Supp. 1990)] or retired railroad supplementary annuities [Kan. Stat. Ann. § 79-32,117(c)(viii) (Supp. 1990)]. Kansas also does not tax Tier I railroad retirement benefits, all or portions of social security benefits, military disability retired pay, Veterans Administration pensions, and disability annuities from the PHS, NOAA and Foreign Service retirement systems. These benefits are excluded from both Federal and Kansas adjusted gross income. 26 U.S.C. §§ 86, 104; 38 U.S.C. § 5301; Kan. Stat. Ann. § 79-32,117(a) (Supp. 1990).

is designed to place federal retirees at a disadvantage vis-a-vis other retirees, public or private.

b. The taxation of military retired pay is "justified by" significant differences between the two classes of taxpayers.

In *Davis*, the State argued that its interest in hiring and retaining qualified civil servants was sufficient to justify a tax scheme favoring retired state and local government employees over retired federal civil service employees. 489 U.S. at 816. Michigan's argument was rejected on two counts. First a mere "rational reason" for discriminating between the two classes of taxpayers was insufficient; an equal protection analysis does not apply when a tax is alleged to violate the doctrine of intergovernmental tax immunity. The relevant inquiry is whether the inconsistent tax treatment is directly related to and justified by significant differences between the two classes, which is a more stringent standard of review than the rational basis test. *Id.* Second, the State's interest in adopting the discriminatory tax "is simply irrelevant to an inquiry into *the nature of the two classes* receiving inconsistent treatment" (citations omitted), and "does nothing to demonstrate that there are *'significant differences between the two classes' themselves.*" 489 U.S. at 816 (emphasis added). These principles are equally applicable here.

The Kansas Supreme Court identified and applied the correct standard of review[16] and expressly noted that it is a higher standard than a mere rational basis. (Pet. App. 34a-35a). The court also determined that differential tax

---

[16] "The crucial issue in the case at bar is whether the inconsistent tax treatment of federal military retirement benefits is "directly related to, and justified by, 'significant differences' " between federal military retirees and state and local government retirees." (Pet. App. 15a).

treatment of military retirees is justified by actual differences between the two classes themselves, not merely by considerations designed to further legitimate state interests. The court based its ruling on the unbroken line of federal authority holding that military retired pay is reduced current compensation for reduced current services and stated, "[a] state is justified in taxing reduced current compensation for reduced current services while not taxing deferred compensation." (Pet. App. 30a).

The characterization of military retired pay as current pay for current services is amply supported by the authorities cited in the opinion below and those discussed *supra* at 15-18. The Kansas Supreme Court noted, but declined to follow, various decisions of other state courts treating military retired pay as deferred compensation.[17] (Pet. App. 30a). The court was clearly correct in relying on the federal precedents.

Pursuant to Art. I, Sec. 8 of the Constitution, Congress has authority to establish and regulate the armed forces of the United States.[18] There is no area in which Congress is entitled to greater deference than in the conduct and control of military affairs. *McCarty*, 453 U.S. at 236. Pursuant to this authority, Congress has enacted a comprehensive statutory scheme providing for the retirement of members of the armed forces. Except where Congress has otherwise

---

[17] *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (T.C. 1990), *aff'd on reconsideration*, 82 Ariz. Adv. Rep. 52, 807 P.2d 1 (T.C. 191), *appeal pending*, No. 1 CA-TX 90-029 (Ariz. App. 1991); *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989), *cert. denied*, 493 U.S. 1019 (1990); *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (1991), *pet. for cert. pending*, Case No. 91-375.

[18] Art. I, Sec. 8, Cl. 1; "The Congress shall have power * * * [12] to raise and support Armies * * * [13] to provide and maintain a Navy; [14] to make Rules for the Government and Regulation of the land and naval forces;"

provided, States are completely preempted from applying their local laws to military retired pay. *See McCarty*, 453 U.S. at 236 (State precluded for application of its community property laws to military retired pay.)

Congress determined that the decision in *McCarty* resulted in inequity to former spouses of military retirees and enacted the Uniform Services Former Spouses Protection Act, Pub. L. No. 97-252, 96 Stat. 730 (1982), ("USFSPA"), permitting States to treat military retired pay as community property for purposes of marital dissolution. *Mansell v. Mansell*, 490 U.S. 581, 584-585 (1989).[19] In 1987, Kansas adopted the USFSPA and amended its Married Persons Act, Kan. Stat. Ann. § 23-201 *et seq.* (1988), to treat military retired pay as marital property for this limited purpose.[20] Prior to this amendment, Kansas had held that military retired pay was not marital property but was merely a future stream of income which would cease at the death of the retiree. *Grant v. Grant*, 9 Kan. App. 2d 671, 676, 685 P.2d 327, *rev. denied* 236 Kan. 875 (1984).

The enactment of the USFSPA and the corresponding amendment to the Kansas Married Persons Act did not cause military retired pay to suddenly become deferred

---

[19] *Mansell* held that the USFSPA did not authorize States to treat as community property military retired pay waived by a retiree in order to obtain disability benefits pursuant to 38 U.S.C. §§ 310, 331 (currently 38 U.S.C. §§ 1110, 1131).

[20] Kan. Stat. Ann. § 23-201(b) (1988) provides, *inter alia*:
All property owned by married persons, *including the present value of any vested or unvested military retirement pay*, whether described in subsection (a) or acquired by either spouse after marriage, and whether held individually or by the spouses in some form of co-ownership, such as joint tenancy or tenancy in common, shall become marital property at the time of commencement by one spouse against the other of an action for divorce, separate maintenance or annulment. (Emphasis added).

compensation.[21] In *Mansell*, the Court stated that Congress may override the characterization of military retired pay as current pay for current services only by enacting an affirmative grant of authority giving States the power to treat military retired pay otherwise, which it clearly has not done in this instance. 490 U.S. at 588. Further, as *McCarty* and *Mansell* indicate, the States' ability to treat military retired pay as marital property is attributable not to any state authority to regulate military retirees but to the grace of Congress, and that which Congress has granted may just as easily be withdrawn.

Petitioners argue that Kansas case law, statutes and administrative regulations purport to treat military retired pay as deferred compensation or a pension. (Pet. Br. 29-33, 39-40). However, even assuming that such authority exists, and assuming further that the characterization of military retired pay under state law should be preferred to that on the federal level, petitioners' argument is self-defeating. If the characterization of military retired pay as either current or deferred compensation is truly a question of state law, then it must be acknowledged that the highest court of the State of Kansas has, at least for purposes of this action, construed and characterized military retired pay as current compensation. If the court below erred in applying its local law, it is not this Court's role to substitute its judgment on matters beyond its sphere of competence. The better view, however, is that, in light of the exclusive federal authority over all aspects of the armed forces, the characterization of military retired pay expressed in *McCarty*

---

[21] *United States v. Tafoya*, 803 F.2d 140, 142 n.7 (5th Cir. 1986) ("The discussion (in *McCarty*) regarding the classification of military retired pay as current pay remains valid."); *Cornetta v. United States*, 851 F.2d 1372, 1382 n.3 (Fed. Cir. 1988) (The USFSPA "did not affect the characterization of military retired pay as reduced compensation for reduced current services.").

is controlling and States are not at liberty to deviate therefrom.

In the Petition for Certiorari, petitioners allege that the decision below conflicts with decisions of other state courts of last resort. (Pet. 6-10). However, these other decisions either assumed military retirees are no different than federal civil service retirees[22] or relied upon state law precedents in the marital property area to conclude that military retired pay is deferred compensation[23] and, hence, not significantly different than state and local government retirement benefits. Several of these decisions await disposition by this Court on writ of certiorari and should be vacated and remanded for consideration in light of the decision to be entered herein.[24]

3. The taxation of military retired pay under the Kansas Income Tax Act is distinguishable from the taxation of federal civil service retirement benefits held invalid in *Davis v. Michigan Department of Treasury*.

As demonstrated above, there are significant differences between military retirees and retired state and local government employees and the differential tax treatment

---

[22] *Bohn v. Waddell, supra; Hackman v. Director of Revenue, supra.*

[23] *Pledger v. Bosnick, supra; Kuhn v. Colorado,* 817 P.2d 101 (Colo. 1991), *pet. for cert. pending,* Case No. 91-980.

[24] *Id. See also Harper v. Virginia Department of Taxation,* ___S.E.2d ___(Va. 1991), *pet. for cert. pending,* Case No. 91-794 (issue regarding taxation of military retirees raised in petition for certiorari although not addressed in lower court's decision). The primary issue in *Harper* is whether federal retirees are entitled to receive refunds of income taxes paid prior to the decision in *Davis*. Respondents submit the Virginia Supreme Court, on remand from this Court, correctly determined that *Davis* does not apply retroactively, and that a State is not required to refund taxes collected under a statutory scheme that was valid at the time the tax was imposed.

at issue is directly related to and justified by those differences. There were no such differences between the two classes of taxpayers in *Davis*. Both federal civil service retirees and retired state and local government employees are fully and unconditionally retired from government service and have no continuing connection with their former employer. Both participate in contributory retirement programs and receive deferred compensation for prior services.

In *Davis* the differences between the two classes of taxpayers articulated by the State of Michigan were based on considerations of state policy, not on any actual differences "between the two classes themselves."489 U.S. at 816-817. Michigan simply perceived its interests could be advanced by treating the two classes differently and proceeded to structure its income tax scheme accordingly. In Kansas, a comprehensive examination of the military retirement system in conjunction with other retirement systems and pensions plans has resulted in an appreciation on the part of the Kansas Legislature of the unique status of military retirees.[25] This, in turn, has resulted in legislative measures providing for the taxation of military retired pay in a manner unlike that of any other form of retirement pay.[26] The Kansas tax treatment at issue is the product of a considered determination premised on appreciable differences between military retirees and all other retirees. It is not attributable to casual indifference to the status of military retirees or to a concerted effort to place military retirees at a relative disadvantage because the Federal Government is the source of military retired pay.

---

[25] See n.3 *supra*.

[26] Kan. Stat. Ann. § 79-32,111b(a) (1989), provides a $120 income tax credit for military retirees age 62 or older that is unavailable to any other retirees.

Petitioners argue that all government employees, including military retirees, are similarly situated and "presumably should be taxed alike." (Pet. Br. 13-15). While it is true that military retirees and retired state and local government employees are both placed on "retired" status and receive retirement pay, this argument favors form over substance and ignores the many differences between the two classes. In reality, the concept of retirement for members of the armed forces is completely different than for civilian employees, and military retired pay "differs in some significant respects from a typical pension or retirement plan." *McCarty*, 453 U.S. at 221. Petitioners skirt these fundamental differences and rely upon a broad and overgeneralized characterization of the two classes to conclude they are similarly situated.

Even assuming these two classes of taxpayers are similarly situated, this merely raises, but does not answer, the question of whether differential tax treatment is permissible. In *Davis*, the Court did not conclude that the taxation of federal civil service retirement benefits was invalid simply because the two classes of taxpayers were both "retired" and received retirement pay. In fact, it was conceded that Michigan's income tax scheme discriminated in favor of retired state employees and against retired federal civil service employees. 489 U.S. at 814. But this was the beginning, not the end, of the judicial inquiry. The Court proceeded to consider whether "the State's inconsistent treatment of Federal and State Government retirees is justified by meaningful differences between the two classes." *Id.*[27]

---

[27] *Cf. Phillips Chemical Co.*, 361 U.S. at 382 ("[T]he discrimination against the United States and its lessee seems apparent. The question, however, is whether it can be justified.").

The mere fact that military retirees and retired state and local government employees may "appear to be similarly situated" is not decisive. *Phillips Chemical Co.*, 361 U.S. at 381. Such an approach would deny respondents the opportunity to justify the differential tax treatment at issue. Even assuming there is a presumption favoring equal tax treatment of all government retirees, that presumption may be rebutted by demonstrating, as respondents have successfully done here, that there are significant differences which justify differential tax treatment of the two classes of taxpayers.

Davis also indicates that a state income tax scheme which discriminates against federal retirees does not, for that reason alone, violate 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity. The only prohibition arising out of the literal language of 4 U.S.C. § 111 is that the tax may not discriminate "because of the source of pay or compensation." 4 U.S.C. § 111. Clearly, the statute erects no *per se* prohibition against discriminatory state tax treatment of federal retirees. If this were true, the initial finding of disparate treatment in *Davis* would have been sufficient to establish the invalidity of the tax and further inquiry as to any significant differences between the two classes of taxpayers would have been superfluous.

The two classes of taxpayers in *Davis* were essentially alike. Where there are no significant differences between two classes of taxpayers, a discriminatory tax can only be seen to differentiate on account of some extrinsic factor such as the source of income. It was for this reason that the Michigan tax scheme was declared unconstitutional. However, a discriminatory tax can be justified if it is based on intrinsic differences "between the two classes themselves." *Davis*, U.S. at 816. Nothing in 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity prohibits

differential tax treatment of two classes of taxpayers that are inherently different.

Since the only type of discriminatory tax treatment prohibited by 4 U.S.C. § 111 is that based on the federal source of pay or compensation, it follows by implication that the statute does not prohibit discrimination based on any other grounds. While it is true that all federal retirees, including military retirees, are entitled to the protection of § 111, it does not follow that all federal retirees are alike and must be taxed in the same manner. Had Congress intended such a result the statute would contain words to that effect. Further, uniform taxation of federal retirees would seem inappropriate in light of petitioners' acknowledgement that "military retirement benefits are unique in comparison to other federal retirement benefits." (Pet. App. 29a).

The taxation of military retired pay under the KITA satisfies the test set out in *Davis* and is therefore valid. When the Court's rationale in *Davis* is applied to the facts of this case, it becomes clear that the KITA does not discriminate against military retirees based on the source of their retirement pay. The facts in *Davis* are distinguishable from those in the present case and the holding in *Davis* does not control the result here.

B. The taxation of military retired pay under the Kansas Income Tax Act is consistent with constitutional and statutory principles of intergovernmental tax immunity.

Davis is rightfully of major significance to a determination of the question presented in this case. However, *Davis* was not decided in a vacuum. It would be myopic to ignore the evolution of the doctrine of intergovernmental tax immunity and the legislative purpose in enacting 4 U.S.C. § 111 as they relate to the taxation of military retired pay under the KITA. Just as the Kansas tax treatment of

military retirees is valid under the test set out in *Davis*, it is likewise consistent with the purposes of constitutional and statutory tax immunity.

1. The taxation of military retired pay under the Kansas Income Tax Act is not repugnant to the implied constitutional doctrine of federal tax immunity.

The seminal case in the field of intergovernmental tax immunity is *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). Incredibly, petitioners fail to discuss, or even cite, *McCulloch*. In *McCulloch*, a state statute prohibited the circulation of bank notes by the Bank of the United States except upon payment of a two percent stamp tax or annual fee of $15,000. Writing for a unanimous Court, Chief Justice John Marshall stated that the incorporation and operation of a bank was necessary to carry into effect certain powers expressly delegated to Congress. 17 U.S. at 406-424. The federal supremacy embodied in the Constitution was held to prohibit a state tax imposed directly on the operations of the Federal Government. There was a "total failure of (the State's) original right to tax the means employed by the government of the Union, for the execution of its powers." 17 U.S. at 430.

Chief Justice Marshall supplemented the immunity doctrine with his opinion in *Weston v. City Council of Charleston*, 27 U.S. (2 Pet.) 449 (1829), where a local tax on federal bond interest was declared invalid. The tax was held to be a burden on the contract between the Federal Government and the bondholder and, consequently, a burden on the power of Congress to borrow money on the credit of the United States. 27 U.S. at 469.

Together *McCulloch* and *Weston* established a rule of absolute federal tax immunity. A state tax imposing either a legal or economic burden on the operations of the Federal Government was deemed to be offensive to the federal

supremacy implicit in the Constitution. This broad rule remained intact for over 100 years and served, to some extent, as a model for the related doctrine of state immunity from federal taxation.[28] For example, in *Dobbins v. Commissioners of Erie County*, 41 U.S. (16 Pet.) 435 (1842), a state income tax on the salary received by an officer of the United States was held unconstitutional. Although it was a personal charge on the individual rather than on the Federal Government, the tax was found to interfere with the means devised to carry into effect the powers delegated to Congress and "present[ed] a case of as strong interference as was presented by the tax imposed by Maryland in [*McCulloch*] and the tax by the city council of Charleston in [*Weston*]." 41 U.S. at 449. Subsequently, in *Buffington v. Day*, 78 U.S. (11 Wall.) 113 (1871), a federal income tax on the salary of a state probate judge was declared unconstitutional.[29]

In the 20th century, the expansive interpretation of the doctrine of intergovernmental tax immunity was stead-

---

[28] The sources of federal and state tax immunity are different, the former being grounded in the Supremacy Clause and the latter in principles of federalism and a concern for state sovereignty. Federal tax immunity has always been regarded as the more extensive of the two doctrines. *South Carolina v. Baker*, 485 U.S. 505, 518 n.11 (1988). Yet they are often spoken of as being reciprocal and complementary in nature. "[A]s the means and instrumentalities employed by the general government to carry into operation the powers granted to it are exempt from taxation by the states, so are those of the states exempt from taxation by the general government." *Willcuts v. Bunn*, 282 U.S. 216, 225 (1931), quoting *Ambrosini v. United States*, 187 U.S. 1, 7 (1902).

[29] "[T]he exemption of the officer from taxation by the general government stand upon as solid a ground and are maintained by principles and reasons as cogent as those which led to the exemption of the Federal Officer in *Dobbins v. Erie Co. supra*, from taxation by the states." *Buffington v. Day*, 78 U.S. at 127.

ily eroded.[30] The pivotal case, *James v. Dravo Contracting Co.*, 302 U.S. 134 (1937), upheld a state gross receipts tax on contractors performing services for the Federal Government. The Court stated that a tax imposed on the earnings of an independent contractor was distinct from a tax on a federal instrumentality and was not invalid simply because it resulted in increased costs to the United States. 302 U.S. at 157-160. "[I]t at most gives rise to a burden which is consequential and remote and is not one that is necessary, immediate and direct." *Id.* at 160, quoting *Trinityfarm Constr. Co. v. Grosjean*, 291 U.S. 466 (1934).[31]

---

[30] *See e.g., Metcalf v. Mitchell*, 269 U.S. 514, 523-524 (1926) (upheld federal income tax on proceeds derived from contracts with state government) (the limitation on the taxing power of either government, in so far as it affects the other, "must receive a practical construction which permits both to function with a minimum of interference each with the other; and that limitation cannot be so varied or extended as seriously to impair either the taxing power of the government imposing the tax (citations omitted) or the appropriate exercise of the functions of the government affected by it."); *Willcuts v. Bunn*, 282 U.S. 216, 225 (1931) (rejected argument that federal income tax on gain from sale of municipal bonds imposed unconstitutional burden on borrowing power of the State) ("[t]he power to tax is no less essential than the power to borrow money, and in preserving the latter, it is not necessary to cripple the former by extending the constitutional exemption from taxation to those subjects which fall within the general application of nondiscriminatory laws, and where no direct burden is laid upon the governmental instrumentality and there is only a remote, if any, influence on the exercise of the functions of government.").

[31] That federal tax immunity was no longer based on the economic burden of a state tax on a federal function was assured in *Alabama v. King & Boozer*, 314 U.S. 1 (1941) (upheld imposition of state sales tax on purchases made by a "cost-plus" federal contractor whereby the full economic burden of the tax was borne by the Federal Government).

Dobbins and *Day* treated the salaries of government employees as immune from taxation on the theory that such a tax burdened the means selected to perform the functions of government. This rationale was rejected and these cases overruled in *Helvering v. Gerhardt*, 304 U.S. 405 (1938), and *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939). *Helvering* upheld the imposition of federal income tax on salaries received by state employees. The reasoning of *Helvering* was found to be "of equal force" in *Graves*, 306 U.S. at 486, where the Court upheld a state income tax on the salaries of federal employees. Several fundamental principles emerge from *Helvering* and *Graves* regarding the constitutional doctrine of intergovernmental tax immunity as it applies to the taxation of salaries paid to government officers and employees. Application of these principles to the facts of this case supports the conclusion that the taxation of military retired pay under the KITA is constitutional.

a. The taxation of military retired pay under the Kansas Income Tax Act does not unduly interfere with the operations of the Federal Government.

The rationale upon which the constitutional doctrine of intergovernmental tax immunity is based was stated in *Graves*:

> The theory of the tax immunity of either government, state or national, and its instrumentalities, from taxation by the other, has been rested upon an implied limitation on the taxing power of each, such as to forestall undue interference, through the exercise of that power, with the governmental operations of the other. 306 U.S. at 477-478.

That the immunity doctrine exists to protect governments, not government employees, is beyond dispute.

"[A]s applied to the taxation of salaries of employees of one government, the purpose of the immunity was not to confer benefits on the employees * * * but to prevent undue interference with the one government by imposing on it the tax burdens of the other." *Id.* at 483-484.

Here, neither the petitioners nor the United States as *amicus curiae* have alleged that the taxation of military retired pay unduly interferes with the operations of the Federal Government. Petitioners give this issue only cursory attention and speculate, without demonstrating, that the Kansas income tax scheme "carries the potential to frustrate the objectives of Congress." (Pet. Br. 41). Such guesswork falls woefully short of the requisite standard. "When immunity is claimed from a tax laid on private persons, *it must clearly appear that the burden upon the* (government) *function is actual and substantial, not conjectural.*" *Helvering,* 304 U.S. at 421 (emphasis added).

Of even greater significance is the statement of interest of the United States contained in the *amicus* brief filed by the Solicitor General. There it is stated that the United States "has a substantial interest in ensuring that those to whom it pays pension benefits receive fair and equitable tax treatment from the States." (U.S. Br. 1). Nowhere does the United States assert that the KITA interferes with the exercise of powers delegated to Congress, with respect to the regulation of the armed forces or otherwise. Contrary to *Graves,* the United States apparently believes that federal tax immunity is designed to protect federal employees, whereas its true purpose is to protect the Federal Government. The inability of the United States to articulate any actual interference with its governmental functions confirms the lack of any colorable basis to support a claim that the KITA offends the Constitution.

Here, as in *Helvering* and *Graves,* the tax is imposed on private individuals and is paid from private funds. "The

theory, which once won a qualified approval, that a tax on income is legally or economically a tax on its source, is no longer tenable." *Graves*, 306 U.S. at 480. To the extent that such a tax results in an indirect economic burden on the government, "that burden is but a necessary incident to the co-existence within the same organized government of two taxing sovereigns and is one which the Constitution presupposes." *Helvering*, 304 U.S. at 424.

The taxation of military retired pay does not impose either a legal or economic burden on the United States nor has it been demonstrated to result in any substantial interference with the operations of the Federal Government. For these reasons, the KITA does not run afoul of the constitutional doctrine of intergovernmental tax immunity.

b. As applied to the taxation of salaries paid to government employees, the constitutional doctrine of intergovernmental tax immunity should be narrowly construed.

The Constitution contains no express limitation on the power of a State to tax the Federal Government or its instrumentalities. The doctrine of federal immunity from state taxation was implied in *McCulloch* as a necessary consequence of the federal system of government. States, by the exercise of their taxing power, are not permitted to retard or impede the operations of the Federal Government. *McCulloch*, 17 U.S. at 436. But federal tax immunity is a zero-sum game. Any expansion of federal immunity results in a corresponding curtailment of the States' power to tax. The Court has therefore concluded that the implied immunity of one government from taxation by the other should, as a principle of constitutional construction, be narrowly restricted. *Graves*, 306 U.S. at 483. A narrow construction is particularly appropriate where, as here, the immunity is invoked by private citizens, for then the im-

munity tends to operate for their benefit at the expense of the taxing government and without corresponding benefit to the government in whose name the immunity is claimed. *Id.; Helvering,* 304 U.S. at 418.

It is conceivable that equalizing the tax treatment of military retirees and retired state and local government employees might somehow further the legitimate federal interest in maintaining an efficient and effective military force. Such treatment would also appear to comport with the Solicitor General's notions of "fair[ness] and equit[y]." But the Supremacy Clause does not confer individual rights and protections, its purpose is to allocate authority between the States and the Federal Government. Petitioners are therefore not relieved of their burden to demonstrate that the Kansas income tax scheme actually interferes with the operations of the Federal Government.

Because there has been no showing that the taxation of military retirees interferes with the operations of the Federal Government, prudential considerations of constitutional construction weigh against extending federal tax immunity to individual military retirees and thereby diminishing the power of the State of Kansas to tax its citizens.

c. There are structural safeguards in Kansas state government which adequately protect the interests of military retirees.

The famous maxim attributed to *McCulloch*—"the power to tax is the power to destroy"—was an expression of concern regarding the lack of adequate safeguards in the structure of state government to prevent abusive taxation of federal interests. *McCulloch,* 17 U.S. at 428. On one hand, a federal tax on a state instrumentality is based on the consent of the citizens of the several States, acting through their representatives in Congress, to a tax on them-

selves and their institutions. It is the act of the whole on one of its parts. The constituents' influence over their representatives is regarded as sufficient to guard against abusive exercise of the federal taxing power. On the other hand, when a State imposes a tax on a federal function, those affected by the tax are often unrepresented in the legislative process of determining whether and to what extent such a tax should be levied. It is the act of a part of the whole. Under these circumstances, there is no "political check" to protect the interests of those subject to the tax and prevent the State from wielding its taxing power with destructive force. *Id.* at 428-429; 435-436.

In this case, however, the individuals who are subject to the tax have full and adequate representation in the state political and legislative process. The members of the class of over 14,000 military retirees are all constituents of the State of Kansas. Together with other Kansans, many of whom are also retirees who pay Kansas income tax on their retirement benefits, they have elected those state legislators and executive officers whom they consider best qualified to serve their interests. In fact, the class of military retirees represented by petitioners includes a current member of the Kansas House of Representatives. In no sense are petitioners disenfranchised with respect to the Kansas statutory scheme here at issue.

The words of Chief Justice Marshall were an echo from an earlier day when the colonies rebelled against taxation without representation. Here, petitioners enjoy adequate representation in state government. There is no justification for invoking federal immunity to set aside a state income tax scheme put in place by the petitioners' duly elected representatives. To do so would amount to judicial overreaching inconsistent with the narrow construction to be applied when federal tax immunity is asserted by private individuals.

2. The taxation of military retired pay under the Kansas Income Tax Act does not violate 4 U.S.C. § 111.

a. The statutory immunity for salaries of federal officers and employees is coextensive with that provided by the constitutional doctrine of intergovernmental tax immunity.

In addition to the federal tax immunity that flows from the Constitution, Congress may, by legislation, grant or withhold immunity from state taxation. *Graves*, 306 U.S. at 478. Shortly after *Graves* was decided, Congress enacted 4 U.S.C. § 111 as part of the Public Salary Tax Act of 1939, ch. 54, § 4, 53 Stat. 575. Section 111 effectively codified the result in *Graves* and permitted States to tax the salaries of federal officers and employees. *Davis*, 489 U.S. at 812. Federal tax immunity was retained in the statute only to the extent necessary to prohibit discrimination against federal officers and employees "because of the source of their pay or compensation." 4 U.S.C. § 111.

Section 111 also "foreclosed the possibility that subsequent judicial reconsideration of *(Graves)* might reestablish the broader interpretation of the immunity doctrine." *Davis*, 489 U.S. at 812. Thus, the statute must be construed in a manner consistent with the constitutional jurisprudence of federal tax immunity existing at the time of its enactment. The immunity retained in 4 U.S.C. § 111 is no more extensive than the narrow scope of immunity discussed in *Graves* and does not provide federal officers and employees with protections not otherwise available to them.[32] Section 111 is not an independent and supplemental

---

[32] *Compare* 4 U.S.C. § 111 with 31 U.S.C. § 742, a statutory immunity provision applicable to federal obliations, which was at issue in *Memphis Bank & Trust v. Garner*, 459 U.S. 392 (1983) (invalidated state bank tax applicable to interest on federal ob-

source of immunity from state taxation for private citizens; its scope is determined by reference to the constitutional doctrine. *Davis*, 489 U.S. at 814.

In enacting 4 U.S.C. § 111, Congress sought to prohibit discrimination by governments against governments, and insure a reciprocal right of taxation in both the States and the Federal Government with respect to the employees of the other. S. Rep. No. 112, 76th Cong., 1st Sess., at 9 (1939). The statute prohibits a state or local tax that "is aimed at, or threatens the efficient operation of, the Federal Government." *Id.* at 12. It does not proscribe discrimination *per se* against individual federal officers and employees.

There is nothing in the legislative history of 4 U.S.C. § 111 to support the conclusion that Congress intended to prohibit the Kansas tax scheme here at issue. The tax neither interferes with the operations of the Federal Government nor attempts to deny the right of the Federal Government to tax state employees or retirees. Given these facts, and inasmuch as 4 U.S.C. § 111 was intended to liberalize the States' ability to tax federal officers and employees, there are no statutory grounds on which to invalidate the Kansas tax treatment of military retired pay.

---

ligations but not to interest on state obligations). In *Garner*, the Court stated that § 742 established a "broad exemption" for federal obligations from state and local taxation, which was in accord with "the long established congressional intent to prevent taxes which diminish in the slightest degree the market value of the obligations issued by the United States." 459 U.S. at 395-396, citing *Smith v. Davis*, 323 U.S. 111, 117 (1944). The contrast between the broad exemption from state taxation contained in § 742 and the narrow immunity reserved by § 111 illustrates that the scope of statutory immunity will differ in each instance depending on the degree to which Congress deems it necessary to protect the federal interest involved.

b. The taxation of military retired pay under the Kansas Income Tax Act does not discriminate against the Federal Government or those with whom it deals.

Both 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity contemplate that a State may tax those who deal with the Federal Government provided it does so in a nondiscriminatory fashion. A tax is nondiscriminatory if it is assessed on the interest of a private citizen in federal property "in common with other property of the same description throughout the state," *McCulloch*, 17 U.S. at 436; if it is imposed on salaries of government employees "derived from their employment in common occupations not shown to be different in their methods and duties than those of similar employees in private industry," *Helvering*, 304 U.S. at 420; and if the tax is also imposed on salaries paid for "like services by other employers, public or private," *Graves*, 306 U.S. at 483-484.[33]

The discussion *supra* at 11-18, regarding the significant differences between military retirees and retired state and local government employees demonstrates that the differential tax treatment of the two classes of taxpayers does not discriminate against the Federal Government or those with whom it deals. Military retired pay is current pay for current services whereas state and local government retirement benefits are deferred compensation for prior services. They are not "property of the same description."

---

[33] Kansas is in accord with this interpretation of the immunity doctrine. *Clinton v. State Tax Commission*, 146 Kan. 407, 71 P.2d 857 (1937) (upheld Kansas income tax assessed on compensation paid to employee of federal instrumentality and rejected argument that such compensation was immune from tax). "[T]he tax in the instant case is in no sense discriminatory. It rests equally upon all whose work differs in no essential character from that performed by plaintiff." 146 Kan. at 424.

Further, military retirees have substantial duties and responsibilities to their employer while retired state and local government employees have none. There are significant differences in their "methods and duties" and their respective compensation is not paid "for like services."

United States v. Detroit, 355 U.S. 466 (1958), upheld a state tax imposed on lessees of federal property. Although the tax at issue applied only to lessees of tax-exempt property, including federal lessees, it sought to put lessees of exempt property on an equal footing with lessees of similar non-exempt property and was held to be nondiscriminatory. 355 U.S. 473-475. Although not central to the holding in *Detroit*, certain lessees of property owned by the State of Michigan were not subject to the tax imposed on other lessees of tax-exempt property, thus creating different tax treatment of certain state lessees compared to federal lessees. However, this did not cause the tax to be declared unconstitutional on the grounds that it discriminated against the Federal Government or its lessees. *Phillips Chemical Co.*, 361 U.S. at 385-386.

Similarly, in *United States v. Department of Revenue of Illinois*, 371 U.S. 21 (1962), the Court summarily affirmed a decision holding that a state sales tax applied to retailers on sales to the Federal Government but not on sales to charities, churches and schools was constitutional and did not discriminate against the Federal Government. These cases indicate that the imposition of a tax on those who deal with the Federal Government is not discriminatory although there are others who are not subject to the tax.

Phillips Chemical Co. v. Dumas Independent School Dist., 361 U.S. 376 (1960), struck down a state statutory scheme that imposed higher taxes on lessees of federal property than on lessees of similar state property. Petitioners' argument relies heavily on *Phillips*, but that case is distinguishable from the case at bar in several important respects.

The Court in *Phillips* stated that an inquiry into the validity of the state statutory scheme required "an examination of the whole tax structure of the state" to determine how "other taxpayers similarly situated are treated." 361 U.S. at 383, citing *Tradesmens Nat. Bank v. Oklahoma Tax Commission*, 309 U.S. 560, 568 (1940). Yet, while the Court specifically found no discrimination between federal lessees and lessees of private property, it failed to consider this fact in determining the validity of the tax. *Phillips*, 361 U.S. at 381. Instead, the Court confined its consideration to a comparison of the narrow class of lessees of tax-exempt public lands.

The Court rejected each of the three justifications offered in support of the validity of the tax. It is true here, as in *Phillips*, that differential tax treatment of those in privity with the Federal Government cannot be justified merely by a State's desire to further its own interests. 361 U.S. at 384. As acknowledged *supra* at 25, the validity of the KITA cannot be sustained upon a mere rational basis. In this sense the two cases are consistent. However, the Court's reasoning on the two other points, while appropriate in light of the particular facts in *Phillips*, is not applicable here.

In *Phillips*, the State of Texas received the rental income from state-owned leases and state statutes mandated the imposition of a lesser tax, or no tax at all, on state lessees. However, the taxing entity was the local school district, not the State. The school district could not offset its loss in tax revenues by increasing the rents on state lessees. Its only alternative was to make up the difference by increasing the tax on all other lessees. 361 U.S. at 384. Here, however, both the income tax exemption for Kansas state and local government retirement benefits and the amounts paid to state and local government retirees are

established under state law. Unlike the school district in *Phillips*, the State of Kansas can achieve the same after-tax result by either paying relatively low gross retirement benefits and providing that such benefits shall be exempt from Kansas income tax or by paying higher gross benefits and taxing them in the same manner as other non-exempt income. It is unimportant whether the State of Kansas elects to tax or exempt state and local government retirement benefits. A tax on such benefits would simply be "a washout," in the sense that the State does not derive any real tax revenue but simply recoups a portion of its up-front employment and labor costs. *Montana v. United States*, 440 U.S. 147, 170-171 (1979) (White, J., dissenting).

Because the State of Kansas is able to control both the amount of state and local government retirement benefits paid and the taxation *vel non* of such benefits, linking the taxation of military retirees to the taxation of retired state and local government employees is an inefficient, and likely ineffective, means of preventing discrimination against the Federal Government and those with whom it deals. The State could pay extraordinarily high gross benefits to its retirees but tax them at a prohibitive rate. Taxing military retirees at the same rate would be devastating yet, under petitioners' theory, this would be a legitimate nondiscriminatory means of taxation. The better approach, as illustrated by *Detroit*, is to require that those who deal with the Federal Government receive the same state tax treatment as their counterparts in the private sector.

Finally, in *Phillips* the Court found that the State of Texas and the Federal Government were engaged in "otherwise identical leasing activities," and the classification erected by the statutory scheme was unrelated to any actual differences between the two classes of taxpayers. 361 U.S. at 384-385. As discussed above, the activities of military retirees are not "otherwise identical" to those of state and

local government retirees. They are significantly different in many important respects. For these reasons, the rationale and result in *Phillips* are not controlling with respect to this case.

United States v. County of Fresno, 429 U.S. 452 (1977), upheld a county tax on possessory interests in tax-exempt property as applied to employees of the United States Forest Service living in homes owned by the Federal Government. The Court stated:

> The economic burden on a federal function of a state tax imposed on those who deal with the Federal Government does not render the tax unconstitutional so long as the tax is imposed equally on other similarly situated constituents of the State. 429 U.S. at 462.

Requiring equal taxation of other similarly situated taxpayers who are residents and voters of the State insures a "political check" against abuse of the State's taxing power at the expense of the Federal Government. *Id.* at 463.

In *Fresno*, there were no differences between those using state or federal property and the two classes received equal tax treatment. *Id.* at 464 n.13. Here, however, in light of the significant differences between them, military retirees and retired state and local government employees are not "similarly situated constituents" of the State of Kansas and *Fresno* does not require that they be taxed in the same manner. Instead, like the Forest Service employees in *Fresno*, whom the Court stated "are no worse off under California tax laws than those who work for private employers and rent houses in the private sector," military retirees are no worse off under the KITA than those who retire from employment in the private sector and receive private sector retirement benefits. *Id.* at 465. Under *Fresno*,

the KITA does not discriminate against military retirees. Military retired pay is taxed in the same manner as most other retirement pay which provides a sufficient "political check" to protect the Federal Government and its retirees from abusive state taxation.

Washington v. United States, 460 U.S. 536 (1983), involved a tax in some respects similar to the taxes at issue in *Detroit* and *Fresno*. The State of Washington routinely imposed a sales tax on purchasers of goods and services. However, on contracts for the Federal Government, state law placed the legal incidence of the tax on the contractor. Although the tax did not apply to non-federal contractors, the statute was upheld as nondiscriminatory. The parallels between *Washington* and case at bar are noteworthy.

In both cases there is a "political check" consisting of "a significant group of state citizens who can be counted upon to use their votes to keep the State from raising the tax excessively and thus placing an unfair burden on the Federal Government." *Washington*, 460 U.S. at 545. Just as the Washington sales tax was applied to federal contractors at the same rate as on transactions between private parties, so too is the Kansas income tax applied to military retired pay at the same rate as private sector retirement benefits. *Id.* Finally, neither Washington nor Kansas has "singled out" those who deal with the Federal Government for discriminatory treatment. *Id.* at 546.

The fundamental flaw in the arguments advanced by petitioners and their *amici* is that they seek to stretch 4 U.S.C. § 111 and the doctrine of intergovernmental tax immunity beyond the limits contemplated by Congress and the Constitution. Federal tax immunity restricts the States' sovereign taxing power only to the extent necessary to protect the operations of the Federal Government from undue interference. *Graves*, 306 U.S. at 483-484. However,

petitioners have seized upon this narrow immunity and attempt to use it as a sword, not a shield, to secure every available tax advantage. They are not content that military retirees are protected against being singled out and subjected to unusual and oppressive state tax burdens, which is the essence of discrimination.

If petitioners' inflated views on the subject of discrimination are accepted, the result will be a substantial and unwarranted infringement upon the State's sovereign power to tax its citizens and order its domestic affairs. Should it so desire, Congress can amend 4 U.S.C. § 111 and extend the immunity to achieve the result sought by petitioners. But until that time, the State's power to tax can be denied only under the "clearest constitutional mandate." *Washington*, 460 U.S. at 546, citing *Michelin Tire Corp. v. Wages*, 423 U.S. 276, 293 (1976).

CONCLUSION

It is respectfully submitted that the judgment of the Supreme Court of the State of Kansas should be affirmed.

MARK A. BURGHART
JAMES A. D. BARTLE *
MICHAEL M. REHM
Legal Services Bureau
Kansas Department of Revenue
Docking State Office Building
Topeka, Kansas 66612-1588
(913) 296-2381
* *Counsel of Record*

February, 1992

Counsel for Respondents